

Sharda Cropchem Ltd.

- Expert in off patent molecules



August 30, 2018

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Intellectual Property (IP) business in Agrochemicals

We initiate coverage on Sharda Cropchem Ltd. (SHCR) with a 'BUY' rating and a price target of INR 504, implying a 28% upside potential from current levels. Our view stems on the fact that the company adopts an asset light business model, focusing on the procurement, marketing and distribution of formulations. The total number of registrations are 2,157 as of March 31, 2018. SHCR has another 978 registrations in pipeline across different geographies.

Asset Light Business Model:

SHCR is engaged in activities of identifying new products and registration opportunities. Once these opportunities are identified, they immediately begin with the process of seeking registration from the regional authorities.

The entire manufacturing of the products is outsourced to vendors in China which further helps them to mitigate the sourcing risk. It is able to maintain an asset light model owing to non-investment in land, plant and equipment for research and manufacturing activities.

Europe and NAFTA remain key regions:

Major share of the revenues of SHCR are from European region (44.7% in Q1 FY19). The management is putting lot of stress on NAFTA region because the market size is very big, and their product portfolio has also become fairly respectable. Also, they have received many registrations in NAFTA region which will be responsible for incremental revenues going ahead.

FY19 Capex requirements:

SHCR has a planned capex of INR 150 crores which will be used primarily for registration of new products across different geographies. SHCR has also started marketing and distributing biocides in various countries such as Spain, France, Italy, Hungary, Croatia, United Kingdom, Slovakia, Slovenia, Belgium, Bulgaria, Greece, Poland, and Czech Republic. As on 31st March 2018, SHCR has 299 biocide registrations.

Working capital improvement:

SHCR is working on managing the working capital situation through inventory management and market collection. SHCR has also reduced its capex guidance from ~INR 200 crores to ~INR 150 crores. They are hopeful of repaying debt raised from the promoters by the third quarter of FY19.

Huge demand seen in Agrochemicals going ahead:

The major drivers of agrochemicals industry are increasing demand for food with rising population and consumer awareness associated with the benefits of fertilizers and pesticides in crop production. Development in technology to boost farm production with increasing government investments in agriculture to increase crop yields provides huge opportunities to this market.

The high growth potential in emerging markets and untapped regions, provides new growth opportunities for the market players. The growth of this market is driven by growing farmer's attention towards superior quality agrochemicals.

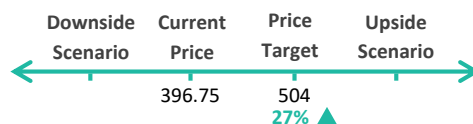
Indian agrochemical companies want to exploit the opportunity opening up with the patent expiry of several significant agrochemicals in the North and Latin American markets. There is a huge opportunity in molecules going off patent and companies applying their trade in such products will be benefitting from this opportunity.

* Read last page for disclaimer & rating rationale

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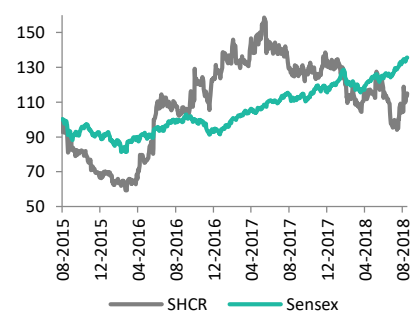
STRONG BUY*



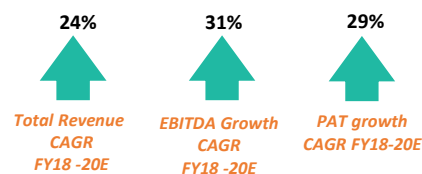
Stock Details	
Industry	Agrochemicals
Sensex	38,723
Nifty	11,692
Bloomberg Code	SHCR:IN
Face Value (INR.)	10
52-w H/L	503.95/ 325
Market Cap (INR. Cr.)	3580

	Valuation Data		
	FY18	FY19E	FY20E
P/E (x)	19	14	11
EPS(INR)	21	28	35

Sharda Cropchem Ltd Vs SENSEX



	Share Holding Pattern		
	Q1 FY19	Q4 FY18	Q3 FY18
Promoters	74.78%	74.78%	74.78%
FIIIs	6.03%	7.88%	7.79%
DIIIs	14.62%	12.89%	12.7%
Retail	4.57%	4.45%	4.73%
Total	100%	100%	100%





Valuation:

We expect the company to notch re-rating in its valuations on the back of:

- Planned capex of INR 150 crore for new registrations in Europe and NAFTA regions
- A strong pipeline of 978 new registrations across different geographies.
- Upturn in the agrochemical market as a whole
- China situation stabilizing

Sharda Cropchem Limited is a generics agrochemical company, with an asset-light business model and a track record of securing registrations in tough and developed markets.

At CMP of INR 396.75 the stock is trading at 6.1x FY20E EV/ EBITDA and 11x FY20E EPS. We value the company using an average of PE and EV/ EBITDA methodology to arrive at a target price of INR 504.

Key Snapshot

(INR crores)	FY16	FY17	FY18	FY19E	FY20E
Revenue	1,222	1,400	1,714	2,212	2,638
<i>Growth</i>		<i>14.52%</i>	<i>22.46%</i>	<i>29.03%</i>	<i>19.29%</i>
EBITDA	271	313	346	456	589
<i>Growth</i>		<i>15.23%</i>	<i>10.61%</i>	<i>31.76%</i>	<i>29.23%</i>
PAT	175	191	191	253	317
<i>Growth</i>		<i>9.20%</i>	<i>-0.14%</i>	<i>32.68%</i>	<i>24.97%</i>
EPS in INR	19	21	21	28	35
Operating Margin(%)	22.21%	22.35%	20.18%	20.61%	22.33%
NPM(%)	14.34%	13.67%	11.15%	11.46%	12.01%
P/E (x)	20	19	19	14	11

Source: NSPL Research

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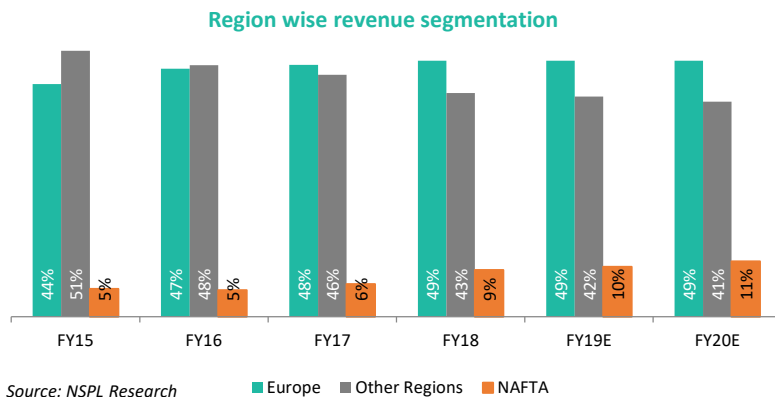
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Investment Rationale:

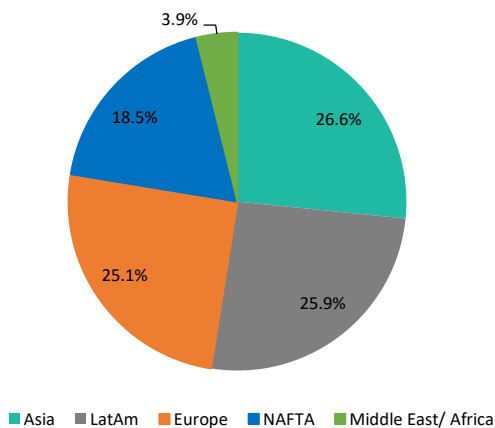
European & NAFTA operations key for future growth:



SHCR’s revenue was driven primarily by the contribution of European and NAFTA region, which constitutes 47.0% and 33.6% of the agrochemical revenues respectively.

The European and NAFTA regions have been key revenue contributors as majority of high margin registrations come from this region. Also, new registrations acquired have helped them grow in these regions. European region comprises of 28 countries which are divided into 3 zones and each zone has a head country. The registration and formulation cost/ molecule is around \$5-7 million and takes around 5 years. The registration of formulation costs around \$2 million and time taken is 2 years. SHCR focuses primarily on European region as the margins are high as compared to other regions. The gross margins from operations in Europe are around 45%.

Region-wise global crop protection market mix



The above figure clearly shows the strength of agrochemical in the NAFTA region. SHCR’s only 9% agrochemical revenues are from this region. This clearly shows that there is enough scope for SHCR to further expand their operations in the NAFTA region. Also this region is a high margin region with a strong pipeline of registrations. The gross margins from operations in NAFTA region are around 25-30%.

Asset Light Business Model:

SHCR’s asset light business model gives them the ability to identify opportunities, attain product registrations and manage costs across multiple geographies and industry cycles.

As SHCR does not own any manufacturing facilities, if any products registered by them are banned or rendered obsolete by the authorities, their only loss is the investment into the respective registrations. This is usually recovered by the company well within the product’s lifecycle. As a result, SHCR can manage having a large product mix and adopt new molecules with relatively more ease than most of their peers. This in return benefits them to build a demand oriented product portfolio. They often prefer registering for molecules with high demand and subsequent high margins as oppose molecules which become obsolete.

The model ensures that SHCR can identify opportunities in different markets and explore these opportunities with ease. Additionally, they employ the same model with the non agro part of business as well, where they work on basis of the orders from distributors.

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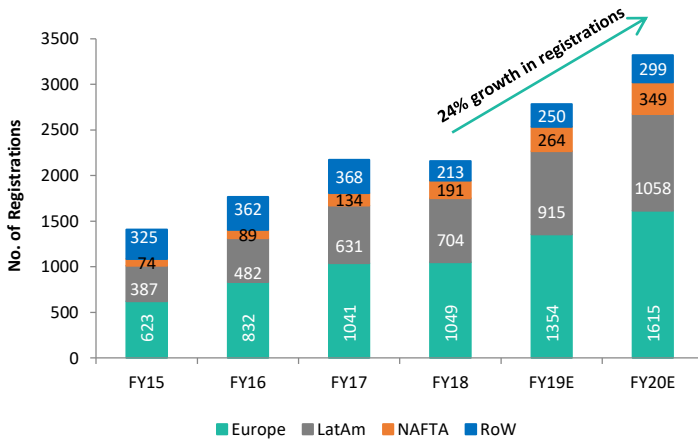
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Management expertise in product registration:



SHCR’s core competency lies in identifying opportunities in generic molecules, and their corresponding formulations and generic active ingredients; preparing dossiers; and seeking registrations in the relevant jurisdictions.

SHCR has been able to overcome the regulatory requirements in these jurisdictions. As clearly visible from the graph, SHCR will continue to focus on seeking registrations in European region. LatAm has always been a difficult region in terms of income collection, but steady number of growth in registrations is expected from there as well.

Source: NSPL Research

For the purpose of registrations, they have appointed consultants in various regions. Apart from the registration process, they also look after sales and marketing in the respective regions. SHCR has 2157 registrations as of now and 978 in the pipeline. The breakup of the existing registrations is as follows: Europe: 1049, NAFTA: 191, LATAM: 704, RoW: 213. SHCR’s library of dossiers and the number of registrations owned have increased progressively.

Global Presence and Diversified Portfolio:



Source: NSPL Research, company

SHCR has operations across more than 80 countries in Europe, NAFTA, Latin America, and Rest of the World. Their presence in different geographies has helped them identify opportunities and helped them to diversify their revenue sources.

Regional Distribution network:

SHCR has set up its own sales force in Europe, Mexico, Colombia, South Africa, India, and other jurisdictions in addition to third party distributors. They have a little above 500 third party distributors associated with them.

Key Risks:

Currency fluctuations:

AS majority of its sales are derived from countries other than India as well as major portion of its raw material procurement is from China, SHCR is always exposed to the fluctuations in the respective country’s currency. In revenue terms, 50% of it is exposed to fluctuations in the Euro/ Dollar and 100% to Dollar/ Rupee. This can result in either benefiting or adversely affecting the Company, depending on the depreciation or appreciation of the Rupee. In cost terms, 65% exposure to fluctuations in Dollar/ Rupee.

Although the company’s huge exports acts as natural hedge against imports, the company also takes plain vanilla hedge against their orders. According to SHCR’s hedging policy, they always maintain 50% hedge for the Euro and 35% hedge for the Dollar.



Patent expiry remain a concern:

SHCR being a global generic agrochemical player always faces high risks from patents laws, which allow the innovator company to extend their patents.

Whenever a rival company has the patent and they see the need to extend, it derails SHCR as they are not able to initiate the registrations of the said molecule in the respective region which leads to them missing the opportunity and subsequently affecting the top line.

Government policies

As SHCR is present in more than 80 countries worldwide they need to comply with the laws and policies of the regional government. Since majority of their revenues coming from agricultural services, the agricultural compliances in respective regions has to followed by them. And any changes in agricultural policies of the government like, reduction in government expenditure in agriculture, a reduction in incentives and subsidy systems, a change in the export policy for crops, a change in the price of commodities, will affect SHCR's business.

Measures to curb pollution in China:

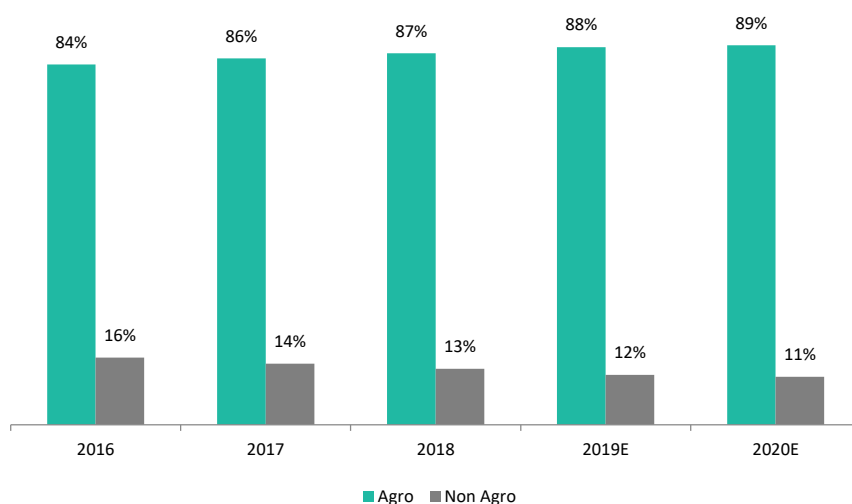
On July 3 2018, China's State Council released the full text of a three-year action plan to curb air pollution by 2020. Air pollution in China is now affecting 37% of China's population, and measures taken so far are falling short of government goals and public expectations. The new plan offers tougher limits and proposes a quicker shift to cleaner fuels such as LNG and electricity, and high grade iron ore, coal and metals.

The situation in China has started to show some signs of revival, with many factories installing the pollution control measures. Some closed factories have resumed manufacturing in alternate factories where the production of this chemical was restricted. However, it is believed that the pressure on margins is likely to persist for the next few quarters as innovators lack the ability to hike their prices due to high levels of inventory in the system, particularly in Europe & LATAM.

About the company:

Sharda Cropchem Limited (SHCR) is a global agrochemicals company engaged in the marketing and distribution of formulations and generic active ingredients in more than 80 countries. They have a portfolio of around 50 molecules. SHCR's management has the ability to identify the developed markets and develop a presence even though these markets have entry barriers which include high cost of registration, stringent testing standards with prolonged approval timeline. SHCR operates two business verticals - agrochemicals business and non-agrochemicals business.

Revenue Segmentation



Source: NSPL Research

Experienced management with strong track record:

SHCR was started by Mr. R. V. Bubna, a Chemical Engineer from IIT, Bombay, with 45 years experience of working in the chemical industry. He together with Mrs. Sharda R. Bubna commenced business operations through their sole proprietorship firms, namely, M/s. Sharda International in 1987 and M/s. Bubna Enterprises in 1989, respectively. Prior to starting SHCR Mr. R. V. Bubna has been associated with Tata Oil Mills Limited, Zenith Limited, Piramal Rasayan Limited, Coromandel Fertilisers Limited and Zuari Agrochemicals Limited. Promoters holding stands at 74.78% in the company.

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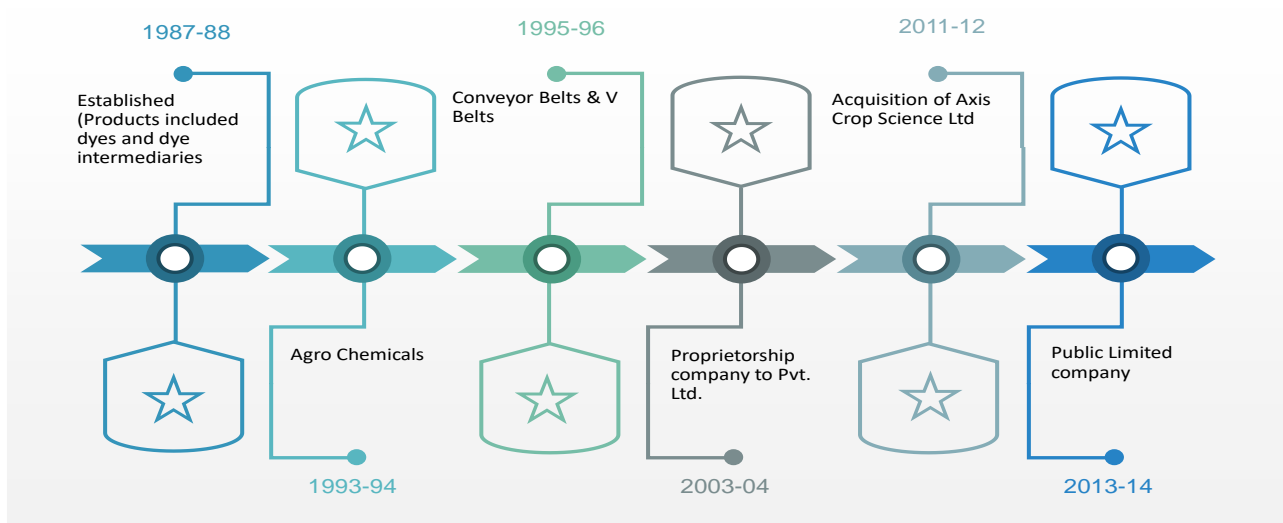
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SHCR Milestones



Source: NSPL Research

Category & Name of the Shareholders	Total no. shares held	Shareholding %
Mutual Funds		14.6
DSP BLACKROCK SMALL CAP FUND	35,12,962	3.89
L&T MUTUAL FUND TRUSTEE LIMITED-L&T EMERGING BUSINESSES FUND	32,87,653	3.64
HDFC TRUSTEE COMPANY LTD - A/C HDFC HYBRID EQUITY FUND	61,52,544	6.82
Foreign Portfolio Investors	54,40,306	6.03
PINEBRIDGE GLOBAL FUNDS - PINEBRIDGE INDIA EQUITY FUND	16,26,675	1.8
PINEBRIDGE INVESTMENTS GF MAURITIUS LIMITED	22,38,355	2.48

Source: BSEIndia.com

Management	Designation
Ashish R Bubna	Whole Time Director
Conrad Fernandes	Chief Financial Officer
Jetkin N Gudhka	Co. Secretary & Compl. Officer
Ramprakash V Bubna	CEO, Chairman & Managing Director
Sharda R Bubna	Whole Time Director

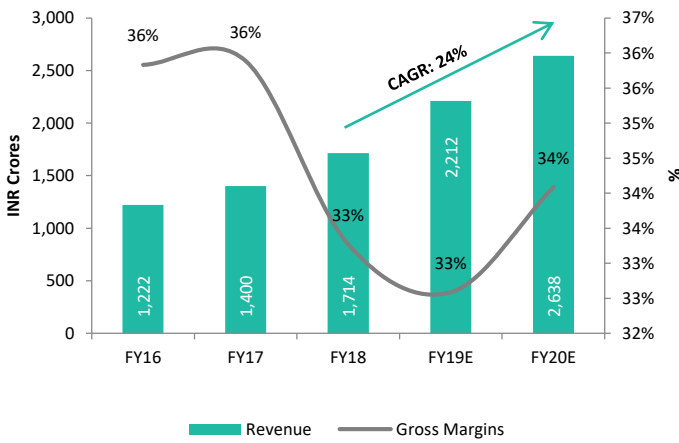
Source: Company, NSPL Research

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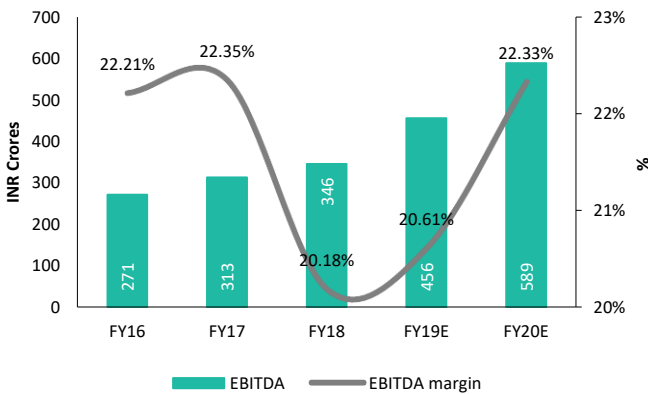
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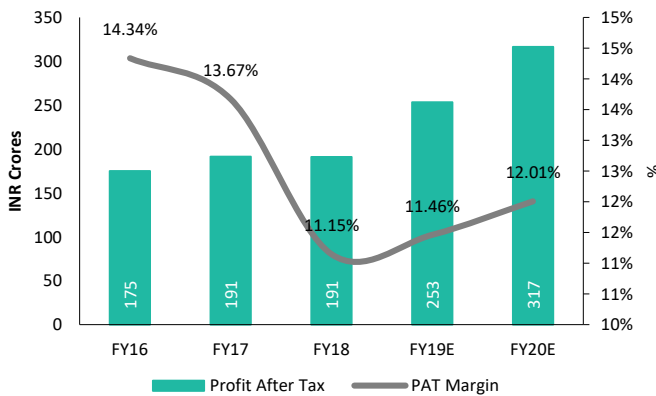
From FY18-20E, the top line is expected to grow 24% CAGR based on our projections. This growth can be attributed to margin pressure easing which was seen clearly in FY18.

During Q1 FY19, gross margins fell as low as 31%, but with situation in China clearing up and the currency stabilizing, margins are expected to return back to normal i.e. around 33-35%.

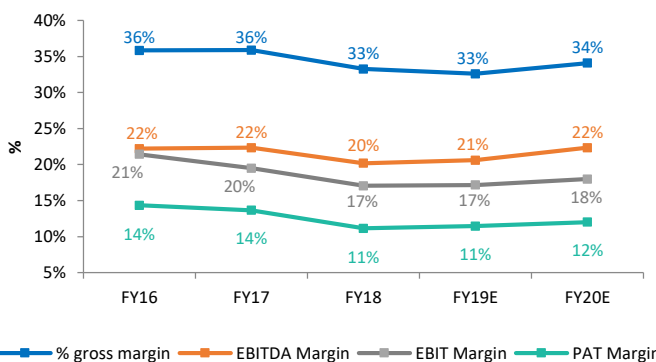


According to the management, the EBITDA margins will be in the range of 18-22% in the coming next 2-3 years.

The EBITDA margins in Q1 FY19 were 18.6%. The reason for shrinkage in EBITDA margins is high raw material cost and uncertain nature of the Dollar and the Euro versus the Rupee. Also, SHCR has a good pipeline of new molecule registrations which will have a positive impact on the EBITDA margins.



The PAT margins have also been impacted because of high input costs as well as high inventory, but new registrations as well as an expected upturn in the agrochemicals industry as a whole will also ensure growth in PAT margins.



IN FY18, margins took a hit because of variety of factors i.e. high input cost, fluctuations in currency and high inventory due to regulatory problems in China. But according to management commentary and our projections, we can see margins reviving in FY19E and FY20E. The upturn in margins can be attributed to their increasing pipeline of registrations, favourable market conditions and raw material and inventory issues resolving.

Source: NSPL Research



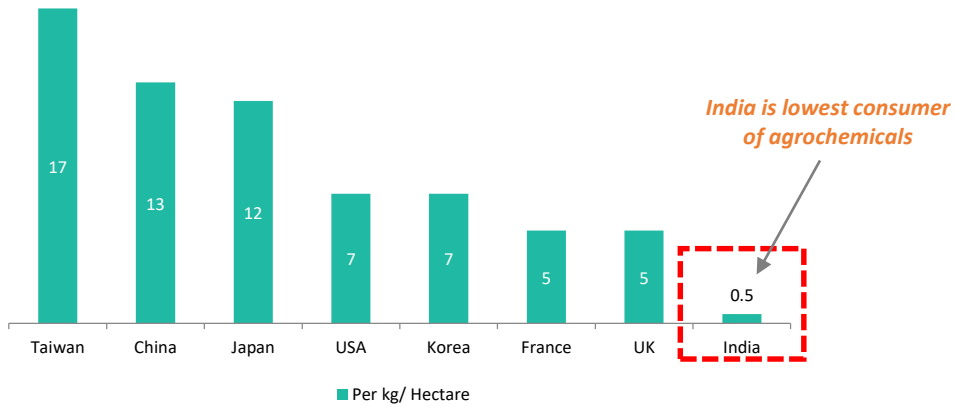
Agrochemical Industry:

Agrochemicals are used in agriculture, horticulture, and floriculture; including a broad range of hormones, pesticides, synthetic fertilisers, and chemical growth agents. Some benefits of using agrochemicals include modifying the needs of crops to suit the changing weather patterns and increasing crop production by using scarce resources optimally.

The ever increasing population and simultaneously decrease in arable land and climatic changes has been posing major problems to this industry. The traditional methods of crop growing and protection seem to be inadequate to meet this high demand. This has led to many companies in the industry accepting new technologies to meet the high demand. There is a growing acceptance to launch advanced agrochemical solutions to achieve higher field productivity. While structurally the demand is expected to remain positive for the above-mentioned reasons, over the shorter run it does get impacted by cyclical factors. These include crop prices, the build-up in inventory across the value chain, climate vagaries, and hosts of other factors.

Over the past few quarters, the agro-chemical industry was impacted by lowering of crop prices, adverse climatic conditions in Brazil and many other Asian countries, higher channel inventories together resulted in the decline of expenditure on agrochemicals. Also, the global agrochemical industry is dealing with the change in environmental norms by the Ministry of Environmental Protection in China, one of the largest contributors to the global agrochemical Industry.

Worldwide consumption pattern of agrochemical (per kg/ Hectare)

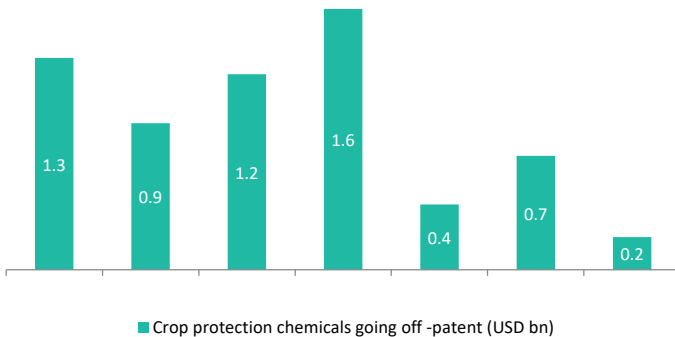


Source: NSPL Research, PI Industries Annual Report 2018

Positive future for generic pesticides:

Products worth ~USD3bn to go off-patent over 2017-20

Crop protection chemicals going off -patent (USD bn)



Source: NSPL Research, UPL Annual Report 2018

Indian agrochemical companies want to exploit the opportunity opening up with the patent expiry of several significant agrochemicals in the North and Latin American markets.

Falling commodity prices have been driving the US and Latin American farmers to shift to generic agrochemicals from expensive patented products. Generic pesticides account for ~60% of the global crop protection market.

The US and Latin American markets account for ~27% and ~17% of the global agrochemicals market, respectively. It has been observed that there is a shift to production to generic agrochemicals, this possess a sizeable opportunity to the companies in this sector.

Along with the huge market share in generic agrochemicals and many crop protection chemicals going off-patent, the opportunity in generic agrochemicals is vast. The global agrochemicals market was at USD 54.5 bn in 2014, up from USD 43.0 bn in 2009, growing at a CAGR of around 5%. It is expected to reach around USD 276 bn by the end of 2022, registering a CAGR (2016-22) of 4.6%.

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Profit & Loss (INR Crores)	FY16	FY17	FY18	FY19E	FY20E
Net sales	1,222.11	1,399.61	1,713.91	2,211.53	2,638.13
COGS	784.25	897.37	1,143.75	1,490.90	1,738.97
Employee Expenses	27.30	28.88	33.54	35.21	36.88
Other Expenses	139.14	160.61	190.69	229.62	273.24
EBITDA	271.43	312.76	345.94	455.80	589.04
D&A	35.05	56.26	69.94	98.16	135.00
Other income	25.45	16.25	16.31	21.76	20.58
EBIT	261.83	272.75	292.31	379.41	474.62
Interest Expense	0.55	0.05	4.85	0.31	0.31
PBT	261.28	272.70	287.45	379.09	474.31
Exceptional Items	6.71	0.00	2.33	0.00	0.00
Tax	86.09	81.39	96.42	125.63	157.57
PAT	175.19	191.31	191.04	253.46	316.74
EPS in INR	19.42	21.20	21.17	28.09	35.11

Balance Sheet (INR Crores)	FY16	FY17	FY18	FY19E	FY20E
Share Capital	90.22	90.22	90.22	90.22	90.22
Reserves & Surplus	715.23	869.62	1044.60	1337.18	1690.04
Shareholders Fund	805.45	959.84	1134.82	1427.40	1780.26

Long Term Borrowings	0.00	0.00	0.09	0.00	0.00
Deferred Tax Liabilities(Net)	54.84	80.73	83.13	104.78	135.33
Other financial Liabilities	0.90	0.55	3.34	0.59	0.49
Provisions	0.93	1.16	2.06	2.66	3.17
Total Non Current Liabilities	56.67	82.45	88.61	108.03	138.99
Short Term Borrowings	2.00	0.24	169.60	134.98	134.80
Trade Payables	383.73	457.43	649.71	776.09	926.49
Other financial Liabilities	59.66	97.24	106.16	136.98	163.40
Other Current Liabilities	19.45	47.38	52.44	67.67	80.72
Current Tax Liabilities (Net)	3.93	4.54	24.03	20.21	4.74
Short Term Provisions	0.40	0.50	0.61	0.79	0.94
Total Current Liabilities	469.17	607.33	1002.55	1136.71	1311.10
TOTAL Equities & Liabilities	1331.37	1649.63	2226.22	2672.38	3230.58

ASSETS

Fixed Assets	1.42	0.96	10.68	12.61	15.03
Capital Work in Progress	0.00	1.33	0.00	0.00	0.00
Goodwill	0.40	0.39	0.40	0.40	0.40
Other Intangible Assets	128.38	208.50	215.22	265.84	330.58
Intangible Assets under development	209.85	231.07	359.95	426.93	545.46
Long term loans	0.051	0.000	0.000	0.000	0.000
Other Financial Assets	0.00	0.0015	0.0015	0.0015	0.0015
Deferred tax asset (net)	2.16	3.38	7.320	4.364	4.982
Non current tax assets (net)	40.54	40.57	40.03	40.30	40.16
Other Non Current Assets	6.00	9.79	29.30	37.81	45.10
Total Non Current Assets	388.81	495.99	662.90	788.25	981.72
Other Current Financial Assets	2.01	0.92	0.00	0.46	0.23
Current Investments	90.18	60.68	22.07	22.18	22.50
Inventories	159.84	287.77	530.39	669.89	762.29
Loans	0.060	0.058	0.000	0.029	0.014
Trade Receivables	619.98	672.56	891.93	1151.21	1337.96
Cash and cash equivalents	64.87	107.96	100.97	17.09	98.16
Other Current Assets	5.64	23.69	17.97	23.18	27.65
Total Current Assets	942.57	1153.64	1563.32	1884.04	2248.81
TOTAL ASSETS	1331.37	1649.63	2226.22	2672.38	3230.58

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Cash Flow (INR Crores)	FY16	FY17	FY18	FY19E	FY20E
PBT	261.28	272.70	287.45	379.09	474.31
Operating profit before working capital changes	269.23	313.48	371.00	475.29	607.05
Operating profit after working capital changes	265.90	238.57	96.95	232.75	506.82
Less income tax paid	-69.26	-56.12	-79.72	-125.63	-157.57
Cash Flow from Operating	196.64	182.44	17.23	107.13	349.25
(Incr)/ Decr in Gross PP&E	-0.42	-3.52	-9.89	-96.23	-132.58
Cash Flow from Investing	-120.28	-348.00	-791.00	-2,177.00	128.00
Cash Flow from Financing	-88.85	-37.88	132.26	43.98	44.07
Incr/(Decr) in Balance Sheet Cash	-5.65	41.02	-10.94	-45.38	81.07
Cash at the Start of the Year	37.99	32.33	73.18	62.47	17.09
Cash at the End of the Year	32.33	73.18	62.47	17.09	98.16

RATIOS	FY16	FY17	FY18	FY19E	FY20E
Profitability					
Return on Capital (%)	32%	28%	22%	24%	25%
Return on Equity (%)	22%	20%	17%	18%	18%
Margin Trend					
EBITDA Margin (%)	22%	22%	20%	21%	22%
Net profit Margin (%)	14%	14%	11%	11%	12%
Solvency					
Total Debt / Equity	0.00	0.00	0.15	0.09	0.08
Valuation Ratios					
P/E	20	19	19	14	11

Peer Comparison	Market Cap	Revenue	EBITDA	PAT	EBITDA Margin	PAT Margin	P/E(x)	ROCE	ROE
Company Name (INR Crores)									
Sharda Cropchem	3580	1,714	346	191	20.18%	11.15%	19	22.4%	16.8%
UPL	34613	17506	3349	2030	19.1%	11.6%	16.2	21.5%	25.8%
PI Industries	10626	1809	264	167	14.6%	9.2%	30.7	25.2%	20.8%
Bayer Cropscience	14884	2749	414	300	15.1%	10.9%	43.9	21.7%	15.7%
Rallis India	3995	1808	264	167	14.6%	9.2%	22.9	20.0%	14.5%

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Sharda Cropchem Ltd				Rating Legend	
Date	CMP (INR)	Target Price (INR)	Recommendation	Strong Buy	More than 15%
August 30, 2018	396.75	504	Strong Buy	Buy	5% - 15%
				Hold	0 – 5%
				Reduce	-5% - 0
				Sell	Less than -5%

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Following table contains the diSHCRosure of interest in order to adhere to utmost transparency in the matter;

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Details of Disciplinary History of NSPL	No disciplinary action is / was running / initiated against NSPL
Research analyst or NSPL or its relatives'/associates' financial interest in the subject company and nature of such financial interest	No (except to the extent of shares held by Research analyst or NSPL or its relatives'/associates')
Whether Research analyst or NSPL or its relatives'/associates' is holding the securities of the subject company	NO
Research analyst or NSPL or its relatives'/associates' actual/beneficial ownership of 1% or more in securities of the subject company, at the end of the month immediately preceding the date of publication of the document	NO
Research analyst or NSPL or its relatives'/associates' any other material conflict of interest at the time of publication of the document	NO
Has research analyst or NSPL or its associates received any compensation from the subject company in the past 12 months	NO
Has research analyst or NSPL or its associates managed or co-managed public offering of securities for the subject company in the past 12 month	NO
Has research analyst or NSPL or its associates received any compensation for investment banking or merchant banking or brokerage services from the subject company in the past 12 months	NO
Has research analyst or NSPL or its associates received any compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months	NO
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Has research analyst served as an officer, director or employee of the subject company	NO
Has research analyst or NSPL engaged in market making activity for the subject company	NO
Other diSHCRosures	NO

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